Joint Committee on Taxation
February 28, 1983
JCX-6-83

LEGISLATIVE ISSUES IN PROPOSALS AFFECTING THE TAX TREATMENT OF REAL PROPERTY WITHDRAWN FROM PRODUCTION AND COMMODITIES RECEIVED WITH RESPECT THERETO UNDER THE PAYMENT-IN-KIND PROGRAM

A. Tax Treatment of Farmers Generally

Under present law, farmers do not recognize income on the crops produced by them until those crops are sold. Additionally, whether income is from the active conduct of farming or is passive source income is important in determining its treatment under a series of provisions of the Internal Revenue Code. Finally, real property used in the active conduct of farming is eligible for a special estate tax valuation election and estate tax attributable to interests in active farming operations can be paid in installments.

Under present law, the fair market value of PIK commodities will be income to the farmer when the right to receive such commodities arises under the PIK program. It is unclear whether such income would constitute income from the active conduct of farming since farm real property is withdrawn from production and no commodities are actually produced under the program. If the PIK commodities are not treated for tax purposes substantially as if they had been produced on the real property withdrawn from production, the tax effect of their receipt may differ substantially from that normally accorded crops actually produced. Likewise, the farm real property withdrawn from production may not qualify for the special estate tax provisions that are available only for property actively used in the business of farming.

B. Income Tax Issues Arising Under the PIK Program

1. Timing of Income

S. 446, S. 495, and S. 527 would defer recognition of income from commodities received under the PIK program until the commodities are sold. S. 495 would provide the deferral on an elective basis. S. 527 would also defer recognition of income from certain storage payments to persons with commodities stored on the farm under the Farmer-Owned Reserve Program until the actual receipt of the storage payments.

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The Ways and Means Select Revenue Measures Subcommittee bill (the "subcommittee bill") is generally the same as S. 446, S. 495, and S. 527 except the subcommittee bill does not provide an election (as S. 495 does) and does not address the issue of storage payments (as S. 527 does).

2. Other Income and Employment Tax Provisions

S. 446 and S. 495 do not address these provisions.

S. 527 would treat income from commodities received under the PIK program as income derived from the active conduct of farming for all purposes of the Internal Revenue Code and the Social Security Act. The bill would treat cooperatives marketing PIK commodities as if they were marketing the product of their patrons.

The subcommittee bill is generally the same as S. 527 except income from PIK commodities would be taxable as self-employment income under the SECA tax and would be treated as earned income under the Social Security Act only with respect to persons who materially participate in the conservation use to which PIK property is devoted.

B. Estate Tax Treatment of Farm Real Property Under the PIK Program

1. Current Use Valuation

S. 446, S.495, and S. 527, and the subcommittee bill would treat real property withdrawn from production under the PIK program as used in a qualified use. S. 495 would also treat real property withdrawn from production under any other Federal farmland removal program as used in a qualified use.

S. 527 would treat participation in the PIK program as material participation, another requirement of the current use valuation provision. S. 495 would provide that withdrawal of real property from production under the PIK program would not be construed to prevent satisfaction of the provision's material participation requirements. S. 446 does not address this issue. The subcommittee bill would provide that the provision's material participation requirements are satisfied by material participation in the conservation use to which PIK property is devoted.

2. Installment Payment of Estate Tax

S. 527 and the subcommittee bill would treat real property removed from production under the PIK program as used in an active farming business for purposes of the installment payment provision. S. 446 and S. 495 do not address this issue.

C. Anti-speculation Rule

S. 446 and S. 495 do not include any anti-speculation rule.

S. 527 would limit the special estate tax rules under the current use valuation provision to a maximum of three years of PIK participation.

The subcommittee bill generally would limit the special tax treatment to interests in PIK real property owned by the taxpayer on February 23, 1983, or to interests acquired after that date by reason of death or gift from the person owning the interests on February 23, 1983, or acquired in any transfer to a family member of that person.

D. Treasury Department Study

S. 446, S. 495, and S. 527 contain no study requirement.

The subcommittee bill requires the Treasury Department (in consultation with the Agriculture Department) to submit further information to the Congress on the effects of the PIK program on income of farm owners and the tax effect of the provisions in the bill.

E. Effective Dates

S. 446 and S. 495 do not include any termination date for their special tax provisions.

S. 527 terminates its special tax provisions with respect to commodities received after April 1, 1986 (i.e., provides benefits for a three year period).

The subcommittee bill applies to PIK commodities received, and real property withdrawn from production, with respect to all crops that would normally be planted before December 31, 1983.

F. Provision Not Directly Related to the PIK Program

S. 446, S. 495, and S. 527 do not include this provision.

The subcommittee bill would exempt from tax the National Farmers Organization as long as it is operated primarily as a collective bargaining agent for its members and does not perform substantial processing services.